



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

All I wish for session 2015 is . . .

Recently announced revenue projections anticipate a modest deposit into the state's Rainy Day Fund at fiscal year's end. However, funds available for next year's budget are insufficient to replace all current spending, which was boosted by tapping cash reserves.

Last year, the treasurer's wish list suggested improvements to the budget process. This year's budget picture underscores the need. After a noble effort in 2013 to phase out dependence on non-recurring revenue, last year's budget reversed course. This year, finding extra money will be much more difficult.

The following is a list of ideas for consideration in the 2015 session:

Endow unclaimed property

As of late, finding enough money to fund state government's core services has proven difficult. Often the default solution is to cobble together non-recurring revenue sources to fund ongoing expenses. The problem is such practices create structural imbalances because the budget is riddled with holes that must be filled with different sources each year.

The state could have a permanent source of tens of millions of dollars each year

that would not require any new taxes or fees if the unclaimed property fund were converted to an endowment in much the same manner as the tobacco settlement fund. With foresight, this favorite grab bag could be transformed from an unpredictable revenue source into a stable, ongoing revenue stream.

Annual budgets/biannual policy

Writing a budget is the top constitutional duty of a legislative body, and even through one is enacted each year, time constraints and competing issues don't always allow for the attention it deserves.

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- State jobless rate at 4.4 percent

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Policy Goals for Session 2015

- ☐ **Endow unclaimed property** – This fund could be transformed into a stable, ongoing revenue stream.
- ☐ **Annual budget/biannual policy** – Changing the structure would help ensure taxpayer resources are appropriately used for essential public services.
- ☐ **Modernize the tax code** – Moving to a lower, fairer, and broader tax system could allow the state to sufficiently fund core government functions.
- ☐ **Address total teacher compensation** – Properly reward undervalued teachers to keep and attract well-qualified professionals to the classroom.
- ☐ **Address needed construction** – Fund a new State Medical Examiner's office and complete the American Indian Cultural Center and Museum.
- ☐ **Adopt administrative efficiencies in pensions** – Gain efficiencies and cost savings in administration of the state's two largest systems.



Guest Commentary By State House Speaker Jeff Hickman

Better financial management

Another legislative session is upon us, and House members are drafting legislation intended to make an even better Oklahoma.

One of the first questions a legislator asks before putting pencil to paper is: What will the budget situation be this session? Considering the tight budget constraints the Legislature had to work with last session, available revenue will be weighed heavily against what can be accomplished.

We see it in the papers and hear it in speeches that our economy is strong and booming. This is absolutely true. Because of pro-business policies, our unemployment rate is 4.7 percent and Oklahoma is now the fourth fastest growing economy in the nation. Every time we have methodically and conscientiously cut taxes, we have seen jumps in revenue to the point that we are now seeing record revenue collections.

So if our economy is so strong, why the tight budget?

The answer is complex, but there are places lawmakers can look to give ourselves a little more wiggle room.

Of the roughly \$10 billion in funds Oklahoma raises through state taxes, fees, investments and other sources, the Legislature only appropriates

about \$7 billion. The other \$3 billion goes to dedicated funds or what some like to call “off the top” spending. The state is bound by statute to direct that money to literally dozens of specific programs and projects.

Many of these projects are of the highest priority. Due to direct funding methods currently in statute, Oklahoma’s roads and bridges are being rapidly repaired and expanded to accommodate our citizens and help commerce flow through our state more efficiently.

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funding constraints
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The Teachers’ Retirement fund is improving and trending towards solvency in the future. Oklahoma’s Promise college scholarships are helping secure a more educated and skilled Oklahoma workforce.



These are worthy projects, and the Legislature must be cautious to ensure these missions can be completed. However, it may be time to evaluate all of the many dedicated funds to determine whether they still fulfill a modern goal. At the very least, lawmakers should consider more flexibility when drafting future legislation regarding dedicated funds. Dedicated funds can create a reliable funding source, give the budget process some predictability and create significant political support, but this must be thoughtfully compared against future revenue fluctuations and possibly hindering future Legislatures from having the power to fix serious budget problems if they arise.

Another area the Legislature must examine more closely is the \$1.7 billion in tax credits, incentives and exemptions. There is no doubt that credits and incentives play an

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Hickman

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essential role in making Oklahoma economically competitive. However, it may be time for the Legislature to create a fair and reasonable system that helps determine whether an incentive is truly sparking economic growth and creating stability in the market, or simply keeping certain

entities alive that are dwindling or unable to stand on their own accord.

Tax credits and incentives can be viewed as another form of investing the Oklahoma taxpayer's money. It's time to begin making those decisions based on reliable evidence and which incentives have the greatest immediate and long-term results.

Neither tax credits nor dedicated

funding constraints are easy issues to tackle, but if addressed, our state stands to benefit greatly. Oklahomans enjoy a healthy job market from a booming private sector, and they should also enjoy a healthy state government that works to invest their hard-earned tax dollars conservatively and wisely. This session, the House will continue working hard to ensure Oklahomans have such a government and can continue to prosper.

Wishes

FROM PAGE 1

Last year, Rep. Randy Grau proposed a way to improve the process by dedicating every year to budgeting, but limiting consideration of non-budgetary items – also known as substantive measures – to every other year. This way, the state could replace the current practice of incremental budgeting, where funding levels are matched to available revenues, with long-term strategic plans built around core responsibilities. Increased focus on the budget would help ensure taxpayer resources are appropriately used for essential public services.

Grau's proposal recently got a big boost with the endorsement of Governor Mary Fallin. It is an outstanding idea that deserves strong consideration by lawmakers.

Modernize the tax code

A state's success is determined by more than any one variable, like the income tax. Instead, it is a matter of achieving

the right combination of taxes, educational attainment, infrastructure and other quality of life issues.

Each session brings a new opportunity to modernize the state's outdated tax structure to better reflect the structural changes that have occurred in our economy in the century since our current system was adopted.

Moving to a fairer and broader tax system with lower rates could allow the state to sufficiently fund core government functions, inject more money into the classroom, stop turning public universities into private ones, boost public safety and health outcomes, and address the needs of our crumbling infrastructure.

Address total teacher compensation

Similar to the agreement struck last session to improve some public employee salaries that were below their private sector peers while adjusting above-market benefits, total

compensation for state educators deserves attention.

Given the current budget outlook and rapidly increasing demand for dollars system wide, it is unlikely that K-12 education will receive a much larger share than the approximately 35 percent it currently claims. Policymakers can develop a multi-year pay plan that better allocates education's share to build a compensation package that properly rewards undervalued teachers to keep and attract well-qualified professionals to the classroom.

Address needed construction

Kudos to the Legislature for passing a bond issue last session to repair the Capitol. Let's keep the momentum going this session.

Accreditation of the State Medical Examiner's office was pulled in 2009, in large part because of an inadequate facility. Five years later, the need still exists because funding has yet to be provided to construct a new facility.

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Wishes

FROM PAGE 3

Also, the fate of the American Indian Cultural Center and Museum needs to be resolved. It is costing the state \$6 million per year in interest and maintenance expenses with no ability to generate income while unfinished. Regardless of the wisdom of starting the project, financial, not political, decisions need to be made in collaboration with Oklahoma City and tribal leaders.

With interest rates still well below historical averages and Oklahoma's net tax-supported debt at less than half the national average, the state could support a bond package to address these capital needs if other means are not successful.

Adopt administrative efficiencies in pensions

The recession forced efficiencies in many areas of government, but opportunities remain. The two largest retirement systems, Teachers and

Public Employees, hold 80 percent of the state's pension assets. Combining the administrative functions of these systems would reduce administrative costs without hurting service levels or benefits, and result in more competitive investment management fees that would save the plans millions each year. Administrative costs are paid from member funds, so money saved in overhead could be used for payment of benefits or funding cost-of-living adjustments.

Preliminary FY-16 estimate shows \$300 million hole

The preliminary estimate for FY-16, certified December 18 by the State Board of Equalization, shows lawmakers will have almost \$300 million, or 4.1 percent, less to spend than last session.

This estimate will be used by Governor Mary Fallin in proposing an FY-16 state budget. The board will make a final

estimate in February for the Legislature to use in writing the budget.

Three primary factors have contributed to the lower spending figure.

Low crude oil prices

The recent drop in crude oil prices is expected to deeply impact revenue

collections during the next fiscal year. Forecasts commissioned by the tax commission show a total negative impact of more than \$230 million on total state revenues, with \$180 million of that lost to the General Revenue Fund (GRF), compared to anticipated collections without the abnormally low prices.

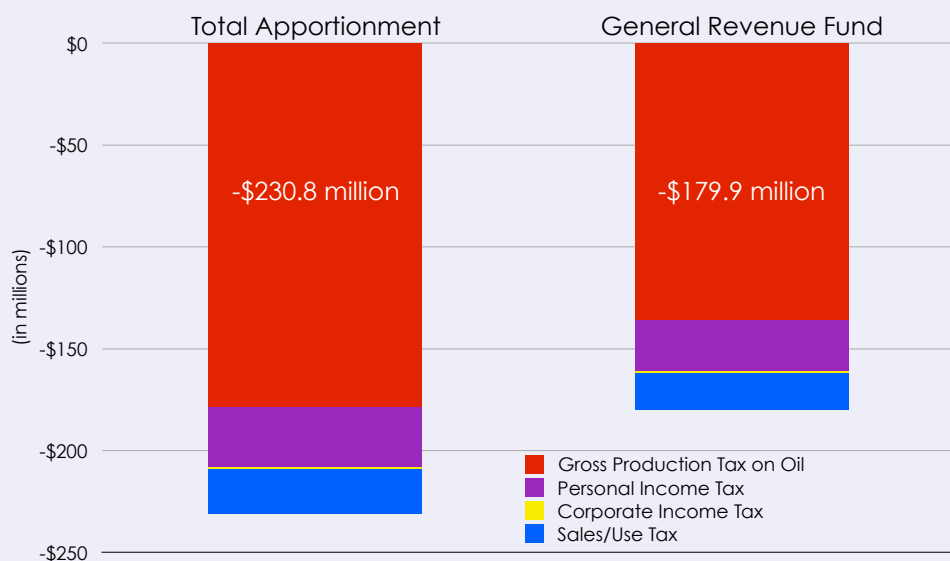
Compared to a baseline estimate, total revenue reductions caused by low oil prices will be seen primarily in the gross production tax, down \$178.7 million, but also in personal and corporate income tax, down a combined \$30.4 million, and from sales and use taxes, down by \$21.7 million.

The OSU Center for Applied Economic Research forecast the loss of 1,000 jobs in the energy sector by the end of 2015 if oil prices stay in the low \$70 per barrel range.

The current budget, for FY-15, set expected oil prices at \$86.99 per barrel. The FY-16 estimate is currently using a price of \$59.97 per barrel, a 31 percent drop.

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The Impact of Low Oil Prices on FY-16 Revenue



Source: FY-16 Revenue Forecast and Declining Oil Prices report, Oklahoma Tax Commission, Dec. 16, 2014



Hole

FROM PAGE 4

Nonrecurring funds

Last legislative session, numerous revolving funds were tapped to bring in more money for appropriations. The money was transferred into the Special Cash Fund (SCF) before being allocated for other uses. These nonrecurring funds helped build the SCF balance to more than \$281 million. For next fiscal year, the SCF balance is estimated to be just over \$100,000 – a reduction of virtually 100 percent.

Tax trigger

Last session, the Legislature voted to cut the state's largest source of recurring revenue, the personal income tax, from a rate of 5.25 percent to five percent if specific revenue requirements were met. The so-called tax trigger would occur if the preliminary FY-16 GRF estimate was equal to or greater than the FY-14 GRF estimate, as certified by the Board of Equalization in February 2013.

Shrinking Expenditure Authority				
(in millions)	FY-15	FY-16	Change	% Diff.
General Revenue	\$5,699.20	\$5,657.71	-\$41.49	-0.7%
Special Cash	\$281.52	\$0.11	-\$281.41	-100.0%
1017 Fund	\$738.63	\$746.46	\$7.83	1.1%
Other	\$493.52	\$510.51	\$16.99	3.4%
Total	\$7,212.86	\$6,914.78	-\$298.08	-4.1%

Source: Office of Management and Enterprise Services

At its December 18 meeting, the statutory requirements were shown to have been met with GRF revenue estimated to be \$60.7 million, or one percent higher for FY-16 than FY-14.

The lower rate will take effect in

January 2016, halfway through the 2016 fiscal year, and is estimated to reduce revenue to the GRF by \$48.9 million. The 12-month impact for the following fiscal year would be approximately double that amount.

Consensus forecasting implemented with FY-16 estimate

December's preliminary estimate presented to the Board of Equalization was built using a consensus process involving tax commission economists and two outside economic research entities.

Established following a review of the processes that had historically been used, the consensus process adds a new dimension to help better estimate expected revenue collections.

In the past, tax commission economists would work with counterparts at

Oklahoma State University and its Oklahoma State Econometric Model (OSEM).

This year, the commission added another firm, RegionTrack of Oklahoma City, to assist in development of economic assumptions critical to the forecasting process.

The OSEM incorporates national and international forecasts and uses historical and expected economic indicators to build a baseline forecast of economic activity.

Each month, the commission inputs data on all tax types it collects and shares its information with OSU and RegionTrack to model projections and provide analysis patterns.

The data is studied to identify trends and isolate anomalies on a monthly and quarterly basis.

The last step is to make adjustments for recent federal and state law changes that are not yet reflected in the historical data.



Gross Receipts & General Revenue compared

The Treasurer's Dec. 4 Gross Receipts to the Treasury report and the Office of Management and Enterprise Services' Dec. 11 General Revenue Fund (GRF) report contain several differences.

November gross receipts totaled \$846.1 billion, while the GRF received \$382.5 million or 45.2% of the total.

The GRF received between 33.1% and 57.1% of monthly gross receipts during the past 12 months.

From November gross receipts, the GRF received:

- Personal income tax: 55.2%
- Corporate income tax: None
- Sales tax: 45.8%
- Gross production-Gas: 40.7%
- Gross production-Oil: 33.6%
- Motor vehicle tax: 7.2%
- Other sources: 49.7%

November GRF allocations missed the estimate by \$2.2 million or 0.6%. Year-to-date revenue topped the estimate by \$80.3 million or 3.7%.

For November, insurance premium taxes totaled \$3.66 million.

Tribal gaming fees generated \$10.61 million during the month.

November Gross Receipts to the Treasury reflect strong sales, softening oil prices

Gross Receipts to the Treasury in November dropped for the first time in 11 months, but it was due to an accounting correction, not an economic factor, State Treasurer Ken Miller announced as he released the monthly revenue report.

Miller said gross receipts for the month are down by \$11.78 million or 1.4 percent compared to November of last year.

“We’re beginning to see the effects of the general decline in oil prices that began in July.”

“Overall, November numbers continue to be healthy, reflecting solid collections in personal income tax and sales tax,” Miller said. “If not for an accounting correction made by the tax commission

last November, which inflated the bottom line by almost \$40 million, gross receipts would have been more than last year.”

Personal income tax and sales tax collections are up over last November

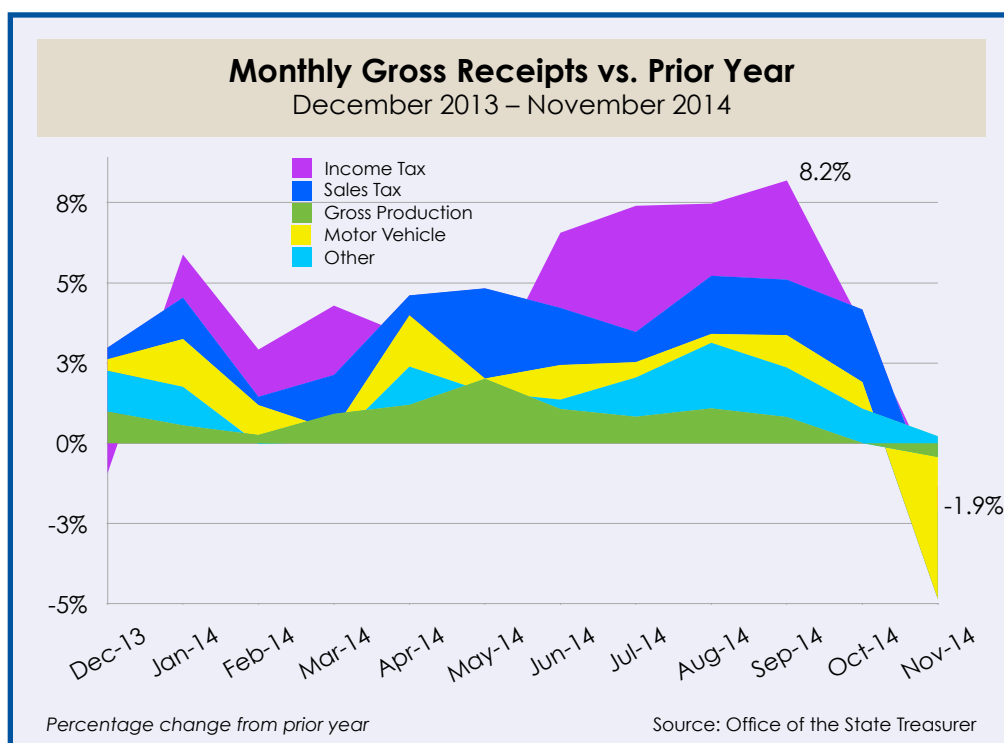
by 2.8 percent and 6.7 percent, respectively. Black Friday sales tax receipts are not yet reflected in collections as they will not be paid to the state until the

middle of December.

The oil field

Collections from the gross production

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State unemployment falls to 4.4 percent in November

Oklahoma's preliminary, seasonally-adjusted unemployment rate was listed at 4.4 percent in November by the Oklahoma Employment Security Commission, down by one-tenth of one percentage point from October and 1.1 percentage point from the prior year.

Compared to November 2013, the number of those listed as jobless dropped by 20,590 people, while statewide employment decreased by 5,140. The national unemployment rate was set at 5.8 percent in November.

State Unemployment Report				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Nov '14	4.4%	1,796,300	1,717,420	78,890
Oct '14	4.5%	1,790,200	1,708,980	81,220
Sep '14	4.7%	1,781,500	1,697,890	83,610
Aug '14	4.7%	1,777,590	1,694,330	83,260
Nov '13	5.5%	1,822,060	1,722,590	99,480

* Data adjusted for seasonal factors

Source: OESC

Revenue

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tax on oil and natural gas slipped below prior year collections in November for the first time in 19 months, down by \$3.72 million or 5.3 percent. November remittances reflect production from

September, when the price of West Texas Intermediate Crude at Cushing was listed at \$93.21 per barrel. The same oil was selling for less than \$70 per barrel in early December. Prices peaked in June at almost \$106 per barrel.

"We're beginning to see the effects of

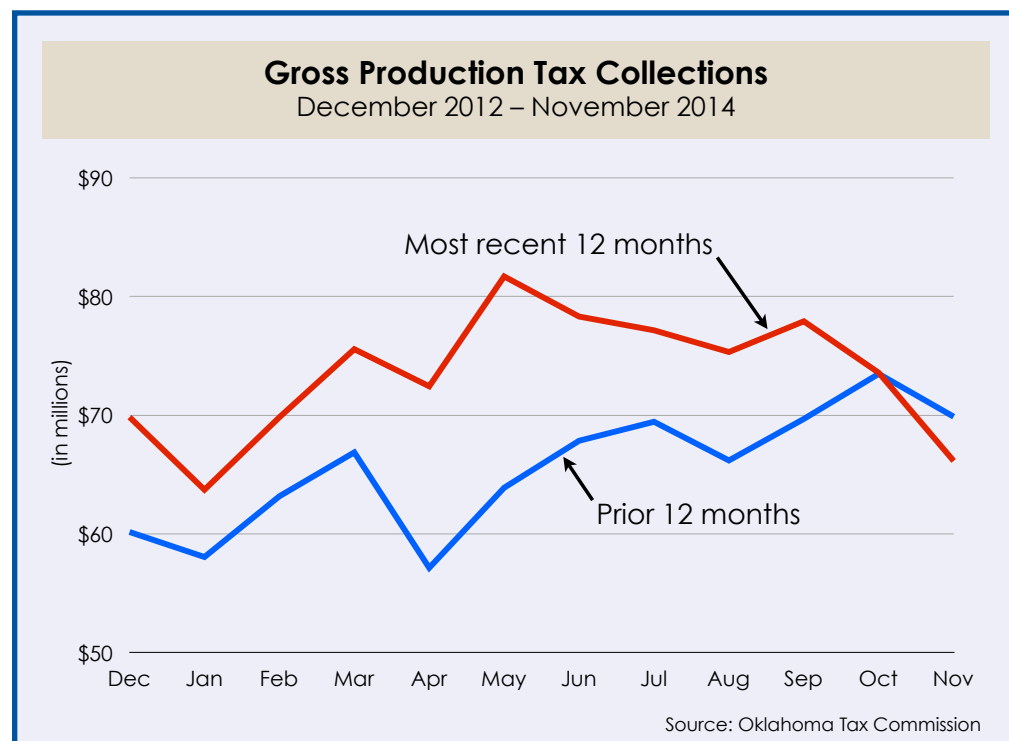
the general decline in oil prices that began in July. However, the impact of today's prices won't be seen for another few months," Miller said.

Noneconomic factors

In November 2013, the tax commission made a deposit of \$39.8 million in motor vehicle revenue that was collected by the corporation commission during prior months but not accounted for due to a switch from paper check payment to electronic transfer. If not for that one-time correction, total gross receipts this month would have been higher than last year by \$28 million or 3.4 percent.

About Gross Receipts to the Treasury

The Treasurer's Office issues the monthly Gross Receipts to the Treasury report to provide a timely and broad view of the state's economy. It is released in conjunction with the General Revenue Fund report from the Office of Management and Enterprise Services, which provides information to state agencies for budgetary purposes.

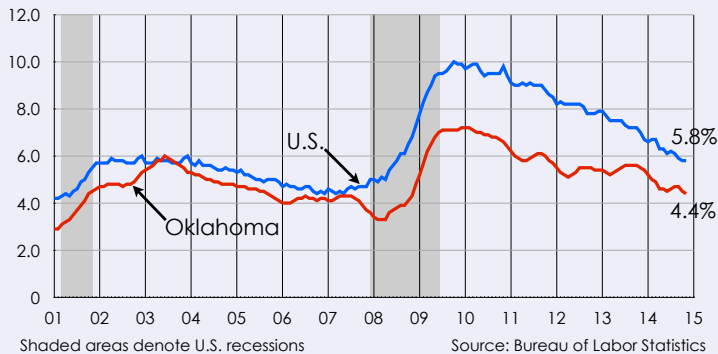




Economic Indicators

Unemployment Rate

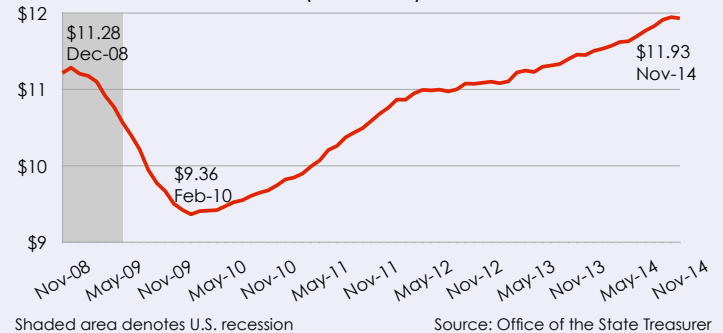
January 2001 – November 2014



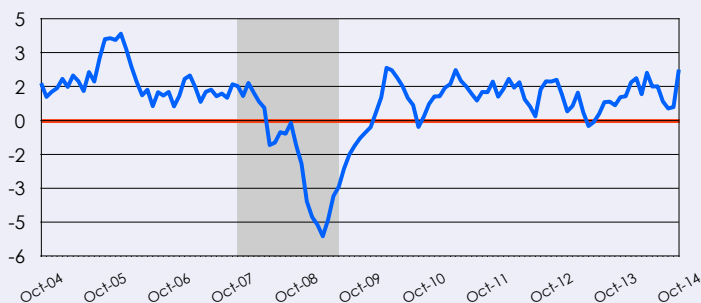
Oklahoma 12-Month Gross Receipts

November 2008 - November 2014

(in billions)



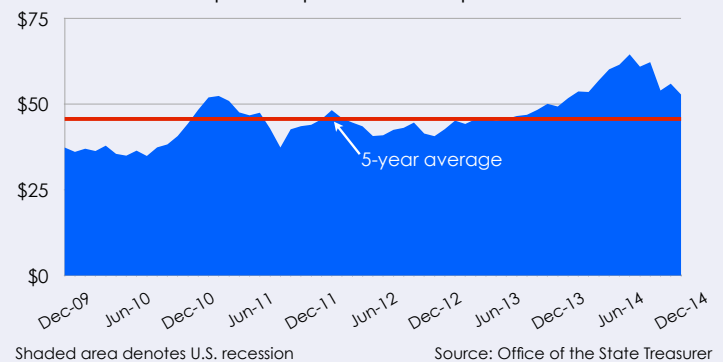
Leading Index for Oklahoma



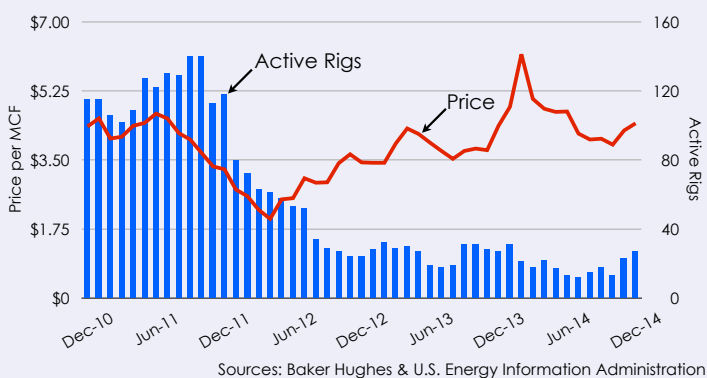
This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings. Shaded area denotes U.S. recession

Oklahoma Stock Index

Top 25 capitalized companies



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

